ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

COMMENTS OF U S WEST, INC.

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SUMMARY

Herein, U S WEST, Inc. ("U S WEST") points out the significant federal interest associated with the definitions of universal service for the general population, as well as for educational institutions, libraries and rural health care providers. While the Communications Act of 1934 certainly reflected such an interest, the Telecommunications Act of 1996 ("1996 Act") clearly defines a national agenda with regard to universal service initiatives, particularly with respect to the provision of affordable service to all citizens in the Nation.

U S WEST previously proposed a Benchmark Cost Model ("BCM"), which incorporated the use of Census Block Groups ("CBG") and ARMIS factors, as an appropriate model to determine "high cost" geographic areas, such that high-cost funding can be specifically targeted to those areas. We continue to support that model, believing that it produces the most reliably-sized federal universal service high-cost fund ("HCF").

We propose a Federal Funding Benchmark ("FFB") of $30.00 per month. Where the BCM indicates it would cost an eligible provider more than $30.00 to serve a particular CBG, the federal USF HCF would provide support to that provider for service to that CBG. Utilizing an FFB of $30.00, U S WEST proposes a HCF of $5 billion.

While continuing to support the BCM/ARMIS in this filing, we do so with the following caveat: The BCM/ARMIS model was not designed to identify (therefore, to recover) the full costs that local exchange carriers ("LEC") experience in providing basic universal service today. These LEC embedded costs reflect investments prudently made in prior years, upon which LECs are entitled to earn full recovery. In addition to the recovery of "high costs" of certain CBGs on a going-forward basis, an imperative agenda item within the context of universal service deliberations require that LECs be able to re-balance their rates to remove implicit support from their rate structures and set rates for services to customers closer to the cost of providing service.

Thus whatever federal HCF is crafted from the instant proceeding, that fund is expected to recover only some, but not all, of the difference between the current price of basic service and the embedded cost of providing

that service. U S WEST will be proposing plans at both the federal and state level to assure that recovery for the remainder occurs.

Beginning with a universal service HCF, additional funding dollars will be required for services to educational institutions, libraries and rural health care providers. The amount of funding required to accommodate the needs of these particular groups will ultimately be dependent on the services that the Federal Communications Commission ("Commission") determines should be included in the menu of services provided, as well as the extent of the discounts (schools) and "comparability" (rural health care) that the Commission requires with respect to such offerings.

Whatever the "total" USF, U S WEST recommends that the funding be accomplished through an explicit surcharge on end-user customers' bills for all telecommunications services purchased (including both voice and data). Upon collection of that surcharge, all telecommunications carriers and providers of telecommunications services should contribute to the fund. The Commission should keep to the bare minimum those providers or industry segments exempted from such contribution requirements under the de minimis theory of the 1996 Act. We believe the current funding mechanism utilized for the Telephone Relay Service ("TRS"), while not a perfect model, provides a good starting place in formulating a workable USF model.

There is significant regulatory and industry benefit to a uniform "universal service" definition and a uniform cost-recovery/contribution mechanism. However, to the extent that states determine that more or different services should be included in the state definition of universal service than in the federal, or determine to charge a basic residential local service rate lower than the FFB, they should be strictly held to the 1996 Act's statutory mandate that they "adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards."

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COMMENTS OF U S WEST, INC.

I. A FEDERAL UNIVERSAL SERVICE PLAN SHOULD BE GUIDED BY ARTICULATED FEDERAL PRINCIPLES

The national concerns with universal service issues, long a part of the federal legislative regime incorporated in the Communications Act of 1934 and the Federal Communications Commission's ("FCC" or "Commission") interpretations and implementation of that Act, are again evidenced in the Telecommunications Act of 1996 ("1996 Act"). It is clearly a matter of national policy "to make available, so far as possible, to all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, nationwide and world-wide wire and radio communication service with adequate facilities at reasonable charges."[1] These services are to contribute to economic development, enhance educational opportunities and provide for broad-based health care services for the "people of the United States."

To achieve the goals set out by the 1996 Act, the Commission is directed to provide a national definition of universal service, to assess the affordability of services included in such definition, to explicitly identify universal service subsidies and to develop a federal universal service fund (or "USF")which will provide the support for the maintenance of affordable service throughout the United States. While States have considerable

[1] The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 86 § 104, amending 47 USC § 151.

responsibility under the 1996 Act, the scope of federal leadership envisioned by Congress in addressing universal service issues is substantial and significant.

Herein U S WEST, Inc. ("U S WEST") proposes a universal service fund that addresses support for both rural, insular and high-cost areas (i.e., the High Cost Fund ("HCF")) and for schools, libraries and rural health care providers. With respect to the former, the HCF, we continue our support for the model we have advocated in the past, i.e., the Benchmark Cost Model (or "BCM"), utilizing ARMIS cost factors. We believe this model produces the most reliably sized HCF. We propose a HCF of $5 billion, which would represent a Federal Funding Benchmark ("FFB") with respect to "affordable" residential basic service of $30.00.

Additional funding dollars would be required for the schools, libraries and health care services. The amount of such funding will ultimately be dependent on the services that the Commission determines should be included in the menu of services provided to educational and library institutions and to health care providers in rural areas, as well as the extent of the discounts and "comparability" that the Commission requires with respect to such offerings.

We propose that the total USF be funded through an explicit surcharge on end-user customers' bills for all telecommunications services purchased.[2] Upon collection of that surcharge, all telecommunications carriers and providers of telecommunications services should contribute to the fund. We believe the current funding mechanism utilized for the Telephone Relay Service ("TRS"), while not a perfect model, provides a good starting place in formulating a workable USF funding model.

In all, our proposal is sound with respect to both "affordability" of universal service and competitive neutrality. Our proposal also positively supports those principles that the 1996 Act states should form the basis

[2] While we understand that the Commission has jurisdiction over only the interstate component of these services, we believe that sound public policy and administrative efficiency supports utilizing the surcharge with respect to both types of services.

for universal service determinations: quality services provided at just, reasonable and affordable rates; access to advanced telecommunications and information services; comparability between high-cost and urban subscribers with respect to basic access and telecommunications services; equitable and nondiscriminatory cost recovery and contribution mechanisms; and specific and predictable support mechanisms.[3]

Our proposal also benefits from its support of other, additional principles that should operate as guideposts in the formulation of any USF proposal. We believe that any federal universal service initiative must be guided by the following seven principles:

1. To the greatest extent possible, the competitive marketplace should be relied upon to define and provide universal service at reasonable rates.
2. Existing rates must be re-balanced for services such as business, toll, access and residential service.
3. If particular customers or groups of customers are to receive support, support must be explicit, rather than implicit.
4. Any subsidies should be targeted to the appropriate low-income individuals, to social programs and to eligible companies serving customers in high-cost areas.
5. High-cost support should be targeted to the smallest geographical area reasonably identifiable.
6. Federal and State universal service funds should be complementary.
7. The size of a USF should not be artificially constrained. Nor should it be "divvied up" according to prior, arbitrary "jurisdictionally separated cost" principles.

As the Commission formulates its post-1996 Act universal service agenda, it is important to keep in mind that the support mechanisms currently associated with universal service obligations were devised in an environment steeped in notions of social compacts, where a local service monopoly was presumed. These

[3] 1996 Act, 110 Stat. at 71-72 § 254(b).

compacts created a complex system of internal pricing support mechanisms[4] which helped maintain low basic rates for all residential customers. These pricing policies imposed upon local exchange carriers ("LEC") were made in an environment where competition did not exist and where participants to the compact felt relatively assured that extended depreciation lives would ultimately allow for the recovery of invested capital. The assumptions underlying this social compact are obviously no longer valid.

Congress clearly acknowledged in the 1996 Act that the local market was (or soon would be) competitive. The emergence of such competition displaces many historical support mechanisms. Thus, at a minimum, well thought out policy changes, with concomitant broadly-based funding proposals are necessary to preserve universal service in the future, particularly with respect to high-cost, rural and insular populations. But that is not the end of the matter.

LECs have the right to recover their full cost of providing universal service, including costs incurred historically. In a competitive environment, these costs cannot -- contrary to past practice -- be recovered implicitly, by spreading the universal service costs fairly ubiquitously across a broad-base of services. Nor should they be.

Universal service "costs" should be specifically identified and recovered. Services which currently provide "implicit" support should be freed from the encumbrance of such support obligations; explicit universal service funds -- state as well as federal -- should be established to address the continued social, regulatory, legislative and industry commitment to universal service.

[4] These support mechanisms include: toll, access, business and vertical services priced at artificially high levels to provide support to residential basic service; statewide rate averaging providing support from low-cost customers to high-cost areas; and extended depreciation schedules which kept revenue requirements down, all resulting in artificially low basic service prices.

Below, U S WEST addresses portions of the Commission's recently issued NPRM.[5] Given space limitations,[6] U S WEST addresses only a limited number of issues herein. First, we address the definition of "universal service," with a particular view to the rural, insular and low-income populations. Second, we address the mechanics of the BCM and its continued validity post-1996 Act enactment. Third, we address cost recovery and contribution methodologies. Fourth, we discuss the appropriate universal service package with respect to educational institutions and libraries, as well as rural health care providers. Included in this discussion, we address the appropriate "discounting" of access to telecommunications and information services provided by telecommunications carriers, as well as "comparability" of prices for services between rural and urban health care service providers.

II. UNIVERSAL SERVICE DEFINITIONS

A. Universal Service Definition For The General Population

U S WEST supports the ubiquitous deployment of a core set of basic telephony services, available to all who want them: one-party service; a voice-grade line with touch-tone capability; access to competing long-distance carriers; access to telephone relay services for hearing or speech disabled customers; dialing access to 911/Enhanced 911 emergency services; and access to directory assistance.[7]

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[5] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, FCC 96-93, rel. Mar. 8, 1996 ("NPRM").

[6] While U S WEST certainly understands, and is sympathetic to, the Congressional time mandates imposed on the Commission, it must be stated that a 25-page limit to comment on a 68-page NPRM seems a bit undue processed. Given the denseness of the NPRM, and the facts that it mostly asks questions and seeks comments, rather than making tentative conclusions, the imposed page limit seems at odds with a full and fair deliberation of the complex, often thorny, issues raised.

[7] In addressing universal service issues, it is important to keep in mind the distinction between universal service and universal access, as well as the difference between support for high-cost areas and support for low-income individuals. Universal service is a core set of services which are ubiquitously available to everyone who wants them. Universal service will be funded to support the provision of these services where the competitive market fails to provide them.

As the 1996 Act acknowledges, the marketplace must be allowed over time to identify the applications most customers actually want and are willing to pay for. In establishing the definition of those component services that constitute "universal service," consideration should be given to "the extent to which such telecommunications services . . . have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers; [and] are being deployed in public telecommunications networks by telecommunications carriers."[8]

Customer choice must be allowed to drive the evolution of those basic elements associated with "universal service" in an information market with evolving information technology. As the legislation clearly contemplates, a service should be added to the universal service definition only when it reaches a high-market-penetration level and there is a net benefit to society from providing the service universally.

U S WEST supports the development of public policies that encourage competing providers to offer more advanced communications services to urban and rural communities on an economically sustainable basis.[9] For example, a federal policy making microwave frequencies available for use in providing telephone exchange service can clearly contribute to the availability of exchange service in remote areas. Government support mechanisms should apply only in those instances where market forces demonstrably fail to result in the deployment of advanced telecommunications services.

New and advanced services, on the other hand, are not automatically deemed part of universal service, nor are they deployed ubiquitously. Universal access (defined as the ubiquitous access to interactive multimedia wired and wireless networks open to all users and providers) to new and advanced services will evolve as market demand makes it economically sustainable to deploy such services. Below, U S WEST addresses universal service and universal access issues with these differences and distinctions always in mind.

[8] 1996 Act, 110 Stat. at 72 § 254(c)(1)(B),(C).

[9] Id., 110 Stat. at 153 § 706(a) (regulatory commissions with jurisdiction over telecommunications services "shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capabilit[ies]").

B. Universal Service Definition For Low-Income Individuals

In the current NPRM, the Commission describes its current LifeLine and LinkUp programs.[10] U S WEST has long supported, and we continue to support, these initiatives. We believe, however, that it would be appropriate for the Commission to examine the caps placed on these programs as rates are re-balanced over time (a competitive necessity) and as basic service rates increase (as States assume their responsibilities under the 1996 Act to provide support for intrastate services at affordable rates).

While supporting the current federal low-income support mechanisms, U S WEST does not believe that federal regulatory intervention is necessary with respect to certain of the other federal "support" mechanisms the Commission identifies for comment. In U S WEST's experience, state regulatory authorities are fully cognizant of the impact of different types of business office and toll access policies on local subscribership. For example, matters such as service deposits, full toll denial ("FDT")[11] and local service denial are being responsibly addressed at the state level. Absent a demonstration that market[12] or state regulatory resolution of these matters seriously impedes federal universal service goals or the implementation of those goals, federal intervention in this area is not necessary.

[10] NPRM ¶¶ 61-65.

[11] FTD blocks the majority of long-distance calling (Interexchange carriers' ("IXC") and U S WEST's toll), but allows for 1-800, 950+, 911, 1+411, 411, 1+620 dialing.

[12] For example, U S WEST has a project called Project Hope Box which is designed to provide help to economically disadvantaged and unemployed individuals by providing them the stability and access of a personal, private number with voice-mail capability. Undoubtedly, other LECs have similar programs or projects in place.

III. A MODEL FEDERAL UNIVERSAL SERVICE FUND FOR RURAL, INSULAR AND HIGH-COST AREAS: U S WEST'S PROPOSED BENCHMARK COST MODEL

In comments and reply comments submitted in CC Docket No. 80-286 last year,[13] U S WEST outlined a comprehensive methodology for the targeting of universal service support to high-cost areas. We believe this methodology remains viable post-1996 Act enactment. The essentials of this methodology consist of the following components:

1. Costs of providing basic service to customers are developed for small areas of geography defined by Census Block Groups ("CBG").[14]

2. Costs are determined using a standard costing methodology, based on current technology and efficient network design.[15]

3. A federal fund would be established to efficiently distribute support to high-cost areas:

    a. An "affordability benchmark" (what U S WEST has called a FFB) would be established to represent a price above which, as a matter of federal policy, basic service is deemed to be not affordable and should be subsidized by an explicit federal high-cost funding mechanism.[16]

    b. CBGs where the cost is determined to be above the FFB would receive the difference between the BCM cost and the FFB through a federal high-cost fund.

    c. Funding would be available to any eligible[17] local service provider serving customers in a qualifying CBG.

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[13] The Commission has incorporated certain aspects of the record from 80-286 into this proceeding, specifically those portions dealing with the BCM and support mechanisms (NPRM ¶¶ 31, 39).

[14] A CBG is a unit of geography defined by the U. S. Bureau of the Census, which includes approximately 400 households. In urban areas, CBGs can be quite small; while in rural areas they can be quite large.

[15] U S WEST, in partnership with Sprint Telecommunications, Inc., NYNEX Corporation and MCI Communications, ("Joint Sponsors") submitted the BCM. Through four Workshops, the Joint Sponsors made the copyrighted software for the BCM available for inspection and comment by interested parties. On December 1, 1995, the Joint Sponsors made an *ex-parte* filing providing complete BCM results for 49 states. (Due to unique circumstances, the BCM was not run for Alaska.)

[16] Comments of U S WEST Communications, Inc., CC Docket No. 80-286, filed Oct. 10, 1995 at 25-27 ("U S WEST Communications Comments").

[17] See § 214(e) of the 1996 Act for a definition of eligible telecommunications carriers.

4. To the extent that the present price for basic service was below the FFB, such differences would be addressed at the state level, through rate re-balancing, interconnection charges, and the establishment of state high-cost funds.

5. The plan described above would be implemented as soon as possible for Price Cap LECs. Non-Price Cap LECs would remain under a funding mechanism similar to the present USF.[18]

In the time since U S WEST first proposed this plan, events, particularly the passage of the 1996 Act, have reinforced the appropriateness of this funding plan for the emerging competitive local telecommunications marketplace. The 1996 Act specifically adds "affordability" of basic service as a national goal, and directs the Commission to develop a "specific and predictable" funding mechanism to assure that this goal is met. The 1996 Act also calls for the development of funds at both the state and federal levels.

With the December 1, 1995 filing of nationwide BCM data, we now have the ability to illustrate the outcomes of several alternative funding strategies. We demonstrate those outcomes below.

Prior to that demonstration, however, U S WEST reiterates something we have stated repeatedly, both in formal comments and informally with industry colleagues and Commission Staff. The BCM, as originally filed, was not touted as a perfect or final model. Rather, it was the result of efforts by a number of industry players to develop a tool for targeting high-cost support. As detailed in subsequent *ex parte* filings,[19] U S WEST has indicated our belief that certain enhancements to the BCM can, in fact, increase its effectiveness. We also believe certain proposals made by Pacific Telesis[20] warrant further analysis and possible incorporation into a final

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[18] In earlier comments U S WEST presented economic and public policy rationales for this bifurcated approach to high-cost funding. U S WEST Communications Comments at 25-29.

[19] In Appendix A, U S WEST outlines some of the *ex parte* activities surrounding the BCM. Furthermore, in the NPRM, the Commission invited comments on several aspects of the operation of the BCM. NPRM ¶¶ 31-34. Because we would categorize most of the requested comments as being somewhat technical in nature (i.e., those variables to be (or not to be) included in the BCM), and because many of these issues have already been addressed and the responses included in various *ex partes*, we include information on these issues in Appendix A, as well.

[20] Reference to the Pacific Telesis *ex parte* is found in Appendix A.

model which can become the foundation for a nationwide system for the distribution of universal service funds to rural, high-cost and insular areas.

In determining the best method of meeting the Congressional mandate for affordable universal service nationwide, it is important to avoid the temptation to engage in a debate over "dueling models." Based on U S WEST's knowledge and experience, models designed to capture high-cost information for universal service support are all attempts to achieve the same result. If the Commission makes the threshold decision that a "proxy modeling approach"[21] represents the most efficient and effective way to target high-cost support in a multi-vendor local marketplace, it should establish an Industry Task Force which, under Commission or Joint Board oversight, could develop a final model process utilizing consensus model assumptions and input data.[22]

The following chart illustrates how the December 1st BCM data can be used to construct a high-cost targeting process, along the lines recommended in U S WEST's plan:

FUNDING BENCHMARK	BCM MCI/HATFIELD	BCM ARMIS	EMBEDDED COST
$20/mo.	$4.0B(illion)	$8.1B	$11.6B
$30/mo	2.2	4.9	7.0
$40/mo.	1.4	3.2	4.6
$50/mo	1.0	2.2	3.2
$60/mo.	0.7	1.7	2.4
$70/mo	0.5	1.3	1.9
$80/mo.	0.4	1.0	1.4

This chart illustrates that the size of a fund necessary, given FFBs of $20 to $80 per month, when measured against the two different expense factors utilized in the BCM,[23] as well as an extrapolation of BCM

[21] U S WEST Communications Comments at 9, n.21.

[22] Id. at 24.

[23] In the BCM documentation, these factors are referred to as Expense Factor 1 and Expense Factor 2. Their values are 31.6765% and 22.97%, respectively. Expense Factor 2 was based upon special studies done by Hatfield Associates for MCI. Expense Factor 1 was developed through a ratio of expenses to investment

costs to embedded cost.[24] Examining this chart, it is evident that the size of the fund is a combination of the funding benchmark chosen and the cost methodology utilized.

IV. FUNDING OF A UNIVERSAL SERVICE FUND FOR RURAL, INSULAR AND HIGH-COST AREAS AND CUSTOMERS

A. Cost Standards For Explicit High-Cost Funding

U S WEST recommends that explicit funding to support rural, insular and high-cost areas be based upon the BCM costs using the ARMIS expense factor. The ARMIS factor takes into account the relationship between investments, expenses and overheads reflected in the historic operation of providers. At the same time, the factor encourages efficiency, since it is applied to an investment level based upon an optimally designed network utilizing forward-looking technology.

Basing explicit high-cost funding on a forward-looking cost standard has an advantage in a competitive local marketplace. The 1996 Act specifically requires that high-cost support mechanisms be available to all "eligible" carriers. Since the BCM approximates the cost of building a network today, it is a reasonable and appropriate means of establishing explicit funding requirements with respect to new market entrants. Using current costs as the basis for the determination of the explicit federal funding component minimizes the chances that high-cost support funds will serve as an incentive for uneconomic market entry.

While U S WEST prefers the BCM/ARMIS approach with respect to current USF HCF matters, we recognize that our choice of model is one that would not cover the full costs which LECs experience in providing basic universal service today. These costs are represented in the Table above by the embedded cost, and reflect investments prudently made in prior years, upon which LECs are entitled to earn full recovery.

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developed from historical ARMIS data. U S WEST Communications, Inc. supported the use of Expense Factor 1 with the BCM in its earlier comments. See U S WEST Communications Comments.

[24] Embedded costs are developed based upon a national ratio (data for the 7 Regional Bell Operating Companies and GTE) of BCM cost per household to USF cost per loop of 0.6965.

As U S WEST has stated repeatedly in the past, explicit high-cost funding is but one element in a comprehensive solution to funding support for universal service. Of greater importance is the ability of LECs to re-balance their rates to remove implicit support from their rate structures and set rates for services to customers closer to the cost of providing service. Thus, a Federal HCF should be expected to recover some, but not all, of the difference between the current price of basic service and the embedded cost of providing that service. We believe that the BCM/ARMIS approach represents a reasonable way to target Federal high-cost support dollars.[25]

B. Level Of The FFB

Determination of the level of the FFB, that level above which BCM costs would be recovered from a Federal HCF, is at best a subjective exercise. The level must be low enough to allow the Commission to meet the Congressionally-mandated objective of assuring that basic service is "affordable" to all Americans. At the same time, it must be high enough that the resultant fund is within the capability of the marketplace to sustain. It must also leave room for individual states to find the right mix of rate re-balancing and targeted State HCFs for their markets.

U S WEST recommends that the Commission establish a FFB of $30/month. This would result in a fund of approximately $5 billion, which we believe is sustainable.[26] A $30 FFB would also leave room for states to establish policies, prices and funds to meet the needs of both the incumbent LECs and their individual state requirements.[27]

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[25] While the BCM/ARMIS approach makes sense within the context of targeting Federal high-cost support dollars, it must be remembered that the BCM results are not the appropriate standard for the pricing of services. LECs are entitled to full recovery of their costs incurred to meet historical carrier-of-last-resort obligations. This recovery should be through a combination of service prices at the federal and state level, as well as federal and state explicit high-cost funds.

[26] The combination of HCFs and funds targeted to schools, libraries and rural health care must meet the test of market sustainability. U S WEST believes that $5 billion is a reasonable amount for the high-cost component of the USF.

[27] See further comment on this issue at supra p.2.

C. How Should Responsibility For Universal Service Support Be Assigned Between Interstate And Intrastate Jurisdictions?

Section 254 of the 1996 Act states that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[28] In defining the role of States, the 1996 Act says that States "may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. . . . A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms."[29]

For jurisdictional separations purposes, the treatment of the Federal funding amounts would be handled in a manner similar to how payments under the present USF are handled today. BCM costs in excess of the FFB would be assigned to the interstate jurisdiction and covered by payments from the Federal HCF.

To the extent that States determine to charge a residential access rate lower than the FFB,[30] or they determine that more or different services should be included in the State definition of universal service than in the Federal, they may do so, provided they devise an explicit funding mechanism for such shortfall and deviations.

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[28] 1996 Act, 110 Stat. at 72 § 254(b)(5).

[29] Id., 110 Stat. at 73 § 254(f).

[30] The Commission, after identifying those "core services" which it proposes would receive universal service support (NPRM ¶17), one of those core services being "voice grade access to the public switched network, with the ability to place and receive calls"), inquires "whether providing universal service support for each proposed service could serve as a barrier to entry by new competitors." Id. ¶¶ 16-17. U S WEST believes that without appropriate state action, it is quite possible that current pricing of basic residential service can and will constitute such a barrier. The current pricing of such service in many state jurisdictions continues to create a situation where true competition will never develop, so long as incumbent LECs must continue to subsidize basic residential service with prices for other services. In fact, absent meaningful reform in the near future, whereby LECs are allowed to raise basic residential service prices, the local rate subsidy problem will only worsen, as LECs will face new costs (e.g., mutual compensation payments) with minimal prospect of increasing local rates to recover these new costs.

V. COST RECOVERY AND CONTRIBUTIONS TO THE USF HCF SHOULD BE BROADLY BASED AND COMPETITIVELY NEUTRAL

Universal service is an overarching legislative, regulatory and social goal. All citizens benefit from the ubiquity of the network, which allows access to others and to information. As such, social and regulatory theory suggests that it should be funded on as broad a base as possible, ideally through general funds.[31] However, despite the long-standing and continued recognition of universal service as a fundamental social good and an integral part of the American social fabric, Congress has determined that the telecommunications industry, rather than the general public, should bear the economic burden associated with USF funding.

The 1996 Act requires that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[32] The Commission should construe the funding obligations under the 1996 Act more, rather than less, broadly.[33] To the greatest extent possible, consistent with the provisions of the 1996 Act, all public network beneficiaries should help to support universal service goals. The Commission should keep to the barest minimum exemptions on the ground that a specific provider's (or industry's) contribution levels would be de minimis. A funding mechanism that is as broad as possible ensures a lower assessment on specific providers and their customers, reducing the universal service support burden borne by any one class of providers or customers.

Within the context of this broadly based funding mechanism, two other principles should guide the Commission in determining the appropriate outline of the mechanism. First, funding should be competitively neutral. To allow for broadly-based contribution requirements in as competitively neutral a way as possible,

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[31] For example, food stamps are deemed to be a social goal and are funded out of general tax funds. The food industry is not required to fund the food stamp program.

[32] 1996 Act, 110 Stat. at 73 § 254(d).

[33] NPRM ¶ 2.

reliance on historical "classifications" must be rejected. As the telecommunications industry evolves, distinctions between and among providers, as well as the services provided, are becoming less and less meaningful.

Second, the funding mechanism should recognize the need for flexible and adaptive policies in an environment where historical and easy "classifications" of providers are blurring rapidly. The funding mechanism should be flexible enough to adapt to changes in the funding base, such as an increase in the size of the base, the entry of new providers, and changes in market share among providers.

Like others in the industry,[34] U S WEST supports USF HCF explicit cost-recovery assessments on individual end users (with respect to the Federal fund, from those users purchasing interstate services). A separate, identifiable item would appear on an end-user's bill for the USF cost recovery. From there, the money would flow to telecommunications providers, who would contribute to the USF itself. This model, we believe, correctly incorporates the two goals mentioned above, producing a broad base of payors (customers of all providers) and a broad base of services subject to contribution obligations, and an "explicit" funding mechanism.

While we appreciate that the Commission is seeking comment specifically on an interstate USF model, given the fact that the Federal/State Joint Board must implement a funding mechanism that can be used in both state and interstate jurisdictions, U S WEST believes the most broadly-based and competitively-neutral model that can be implemented should be the model that is implemented.

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[34] We believe similar arguments will be proffered by the United States Telephone Association, as well as Southwestern Bell Communications. See also Supplemental Comments of AT&T on the Proposed Rules Regarding the Implementation of the Colorado High Cost Fund, Colorado Docket No. 95R-558T, filed Feb. 26, 1996.

A. The Current TRS Cost Recovery/Contribution Model Can Be Adapted To Be A Sound USF Cost Recovery/Contribution Model

The current TRS fund provides a potential funding model that might be utilized within a universal service context.[35] While U S WEST does not believe that this model, in its entirety, is appropriate in a USF environment, there are aspects of the model which we believe are quite appropriate. First, to the extent that the model seeks cost recovery from a broad base ("[c]osts . . . [should] be recovered from all subscribers for every interstate service"),[36] we believe it is a good model and one that should be replicated in a USF environment. Second, we think the type of providers contributing to the TRS fund is broadly based, and could form a sound basis for replication in a USF environment.[37]

Like the aspects of the TRS model U S WEST considers appropriate in a USF environment, the shortcomings of the TRS model are also twofold. First, unlike certain state models,[38] the current interstate TRS recovery model does not explicitly identify the TRS "cost recovery" on the end-user's bill. The cost recovery is allowed to be handled as a carrier's "cost of doing business," an approach we believe is not competitively neutral and is inconsistent with the 1996 Act's direction that USF matters be treated explicitly.[39] We discuss our opposition to the TRS "implicit" cost-recovery mechanism within the context of a USF HCF below.

[35] 47 USC § 225.
[36] 47 CFR § 64.604(c)(4)(ii). And see id. at (iii)(A). U S WEST supports funding based on retail revenues, rather than on gross revenues. Thus, we would eliminate the "access" products from the interstate products on which cost recovery and contributions would be assessed.
[37] These service providers contribute based on both voice and data services, which U S WEST believes is absolutely essential with respect to USF funding.
[38] In the majority of U S WEST's states, TRS costs are recovered utilizing a specific line-item identification on the end-user's bill.
[39] "[S]upport should be explicit and sufficient to achieve the purposes of this section." 1996 Act, 110 Stat. at 73 § 254 (e).

Second, the TRS model works off of gross revenues, which U S WEST does not believe is appropriate. In a USF environment, U S WEST would include only costs associated with retail telecommunications services, not with wholesale services.[40]

With respect to the lack of specific identification of the TRS cost recovery on the end-user's bill, U S WEST does not support the model. When support for certain social goals (such as TRS and universal service) is recovered through rates as a general cost input, the support mechanism and its recovery become implicit, perpetuating the implicit subsidy problem inherent in rates today. We believe that the approach taken by Vermont, for example,[41] where the USF assessment is specifically identified on the bill, is the more appropriate approach from a public policy perspective, as well as more aligned with the 1996 Act's mandated approach.

Furthermore, including the assessment as a cost of doing business is not competitively neutral, as long as one provider is subject to a different set of regulatory rules than another provider. Were the universal service funding costs permitted to be included in a provider's overall "cost of doing business," all providers would have to be on the same market footing. That is, each and every provider would have to have the flexibility to increase any or all of its rates to cover these costs. Because all USF HCF providers predictably will not be on the same footing in this regard, a "cost of doing business" approach is inequitable and competitively disadvantageous to incumbent LEC providers, in particular.

When an incumbent LEC is constrained from raising its rates with respect to one particular category of service (e.g., local residential service), it will be required to focus all of its increased USF "cost of doing business"

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[40] The assessment would not apply to wholesale transactions between service providers, where the wholesale service is a component of a service provided to an end user (e.g., access being a component of long-distance message toll service).

[41] The Commission and the Federal/State Joint Board should look to the funding mechanism implemented in the state of Vermont as a model. Vermont legislation allows for and has implemented an end-user surcharge on retail revenues.

recovery on its more competitively vulnerable services, thus disadvantaging it vis-à-vis its competitors. Similarly, even if a local service rate increase is not absolutely prohibited, if that LEC must suffer time-consuming regulatory proceedings to increase its rates to cover its USF HCF costs, while other competitive providers can recover the costs any time, any way they want, the incumbent LEC is disadvantaged. In either event, the LEC faces the unattractive "choice" of raising its more competitive rates, both disadvantaging itself in the marketplace and perpetuating the insidiousness of implicit supports.

B. The Other Proposed Models Are Not Appropriate For A USF HCF

Despite its deviation from the preferred "retail revenues/specific identification on end user's bill model" argued above as the most appropriate, the TRS model -- while far from perfect -- would be preferred over the other proposals mentioned by the Commission.[42] The second alternative, a mechanism similar to that established in the Commission's Regulatory Fees Order,[43] would require contributions based on revenues, net of payments to other carriers (e.g., total interstate toll revenue minus access charges paid).[44]

As we have indicated above, we believe the most efficient way to handle USF funding is to base assessments on the retail revenues of telecommunications service providers. The Regulatory Fees Order approach allows certain providers (e.g., IXCs, CAPs, etc.) to pay fees "based on gross interstate revenues net of payments made to other telecommunications carriers."[45] For many IXCs, this equates to an assessment on net retail revenues. On the other hand, other providers (e.g., incumbent LECs), having no current "payments to other carriers," contribute based on their total gross revenues, which include both their end-user retail revenues (net nothing) as well as their wholesale service revenues.

[42] NPRM ¶ 122.

[43] In the Matter of Assessment and Collection of Regulatory Fees for Fiscal Year 1995, Price Cap Treatment of Regulatory Fees Imposed by Section 9 of the Act, Report and Order, 10 FCC Rcd. 13512 (1995).

[44] NPRM ¶ 123.

[45] Id.

This is obviously an inequitable and unfair result. Thus, while the Regulatory Fees Order approach appears to address what U S WEST sees as the "double assessment" problem associated with the existing TRS recovery mechanism, its application is not accomplished in a competitively neutral manner.[46] Thus, we oppose it.

Nor is this model easily administered. For it to work in a manner that was competitively neutral, the Commission would have to allow incumbent LECs to net out imputed access from their toll revenues, for example.[47] While "competitive neutrality" might be achieved by this treatment of incumbent LECs, U S WEST still would not favor this approach because it produces -- in its efforts to achieve parity -- a reduction in the funding base. The retail revenue approach does not suffer from this infirmity. Because of the potential to favor one competitor over the other and the complex scenarios raised by the net-of-payments option, the option should be rejected and the retail methodology should be adopted.

The final Commission-described option, contribution based on per-line or per-minute units, should be rejected for the reasons discussed in the NPRM.[48] As the NPRM implies, this would require the Commission to immerse itself in the adoption and administration of "'equivalency ratios' for calculating the contributions owed by providers of services that were not sold on a per-line or per-minute basis into . . . respective per-line or per-minute units."[49] We believe this methodology is simply too complex for the benefits that might be derived from it. This is particularly the case because, as the Commission acknowledges, the "approach[ ] may favor certain services or service providers over others."[50]

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[46] Attached as Appendix B, U S WEST provides a mathematical equation showing the operation and effects of a Regulatory Fees Order approach to USF HCF funding, as compared to U S WEST's preferred approach.
[47] This phenomena is described in more detail in Appendix B.
[48] NPRM ¶ 124.
[49] Id.
[50] Id.

Clearly, U S WEST's proposed funding alternative, based on retail end-user revenue, is superior to the three alternatives discussed in the NPRM. The retail option is the most easily administered; and it benefits from its competitive neutrality. For the reasons outlined above, it should be adopted by the Joint Board and the Commission.

VI. UNIVERSAL SERVICE CONSIDERATIONS FOR SCHOOLS, LIBRARIES AND HEALTH CARE PROVIDERS

A. General Considerations Regarding The Universal Service Definition And The Fund Size

An obvious goal of the 1996 Act, as it pertains to telecommunications and information access to schools, libraries and rural health care providers, is to provide affordable access to advanced telecommunications services to those institutions that do not currently have them.[51] The 1996 Act requires that the additional services targeted for support through universal service mechanisms must be offered to schools and libraries at a discount and to rural health care providers at rates comparable to rates for the same services in urban areas.[52]

The determination of the funding necessary to support these subsidies is dependent upon two factors:

1. The menu of services which are determined to be eligible for discounted provisioning, and
2. The amount of discount determined to be appropriate by State and Federal regulators.

The larger the "menu" of services for which USF support is required, the greater the pressure to increase the overall size of the USF. Furthermore, as the menu gets larger, less discounting can reasonably be expected to occur. For example, a service menu reflecting $10 billion, with a 50% discount, results in a USF school/health care support fund of $5 billion. A service menu reflecting $100 billion, with a 50% discount, results in a $50 billion support fund. Or, stated another way, a $5 billion support fund for educational institutions and libraries, as

[51] 1996 Act, 110 Stat. at 72 § 254(b)(6).
[52] Id., 110 Stat. at 73-74 §§ (h)(1)(B), (h)(1)(A).

well as health care providers, will produce a 50% discount when the service menu involves services valued at $10 billion; but only a 5% discount with respect to a service menu valued at $100 billion.

There obviously is some practical cap on the total size of a Federal USF fund (including funding for both rural, insular and high-cost areas, as well as schools, libraries and rural health care) sustainable in the telecommunications marketplace, from both a regulatory and an industry perspective. Yet, as can be discerned from the above, the broader the service menu is defined, or the greater its value, the larger the support fund must be or the smaller the discount possibilities.

Since most schools, libraries and rural health care providers operate in an environment of limited funds and tight budgets, it makes sense for regulators to find the mix of services which best meets the needs of these institutions for basic service functionality, at the lowest total price. By so doing, maximum discounts can be applied to the lower prices.

While the service proposals we make below may appear to some to be unduly modest, given the scope of available technology, we believe they incorporate immediately useful services at reasonable costs, which would allow for the maximization of discounting.

B. <u>The Universal Service Definition Or Service Menu</u>

The Commission seeks specific comment on what services, over and above those included in the general "universal service definition" package, should be made available to eligible schools and libraries and what an appropriate discount might be. Inquiry is also made on what services should be made available to eligible rural health care providers, at rates comparable to those in urban areas.

Based on U S WEST's experience serving the educational and health care communities in our 14-state territory over many years, U S WEST proposes the following for consideration. Upon a bona fide request, any